S. HRG. 99-120 PT. III

Addendum
COMPREHENSIVE REFORM IN THE FINANCIAL SERVICES INDUSTRY

HEARINGS

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

NINETY-NINTH CONGRESS

FIRST SESSION

ON

THE NEED FOR COMPREHENSIVE LEGISLATION WHICH WILL PROVIDE NATIONAL POLICY DIRECTION TO THE FEDERAL REGULATORS AND FINANCIAL INSTITUTIONS TO ADDRESS THE COMPETITIVE ISSUES, THE CONSUMER PROTECTION ISSUES, AND REGULATORY ISSUES BEING RAISED BY THE ONGOING RAPID CHANGES IN THE FINANCIAL SERVICES INDUSTRY

PART III

JUNE 13 AND 19, 1985

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ADDENDUM

This addendum is being published due to the inadvertent omission of the committee's written questions and responses from the following witnesses:

James A. Baker III, Secretary of the Treasury, and

William J. Stallkamp, member, board of directors, Consumer Bankers Association.

The committee regrets this error.

DEPARTMENT OF THE TREASURY
WASHINGTON

ASSISTANT SECRETARY

October 28, 1985 1985 OCT 24 AM 8 21

Dear Mr. Chairman:

Enclosed are answers to the questions you and other members of the Committee sent Secretary Baker in connection with the June 13, 1985 hearing on changes in the financial services industry. Thank you for giving us this opportunity to express the Administration's views on these important issues.

Sincerely,

Bruce E. Thompson, Jr.
Assistant Secretary
(Legislative Affairs)

Answers to Questions Submitted by Chairman Garn

QUESTION 1

Many in Congress are concerned about the impact on the safety and soundness of the banking system of allowing bank holding companies to engage in new activities. Do you think it is in any way dangerous to the banking system to expand the securities activities of bank holding companies?

ANSWER

I do not believe that the activities we have proposed, including activities "of a financial nature" as determined by the Federal Reserve Board, would in any way threaten the safety and soundness of the financial system or the federal deposit insurance funds. We would not be proposing these activities if we thought they posed undue risks to individual financial institutions or to the financial system as a whole. In fact, permitting bank holding companies to engage in such activities would enhance competition and promote competitive equity.

The holding company structure provides important safeguards that the marketplace should not ignore. A holding company is a shareholder of the depository institution. The holding company's losses are borne ultimately by its shareholders and creditors, not by creditors or depositors in the depository institution. Thus, the depository institution, its creditors and depositors, and the Federal insurance funds are insulated legally from the risks associated with nonbanking activities conducted in the holding company and its nonbanking affiliates.

As the Treasury Department stated in response to questions you submitted after the July 18, 1983 hearing on FIDA, if a bank and its affiliates used the same name, we recognize that to a degree the marketplace may perceive them as the same entity. However, on balance, the benefits to bank and thrift holding companies of competitive equity with other multiproduct financial service firms may substantially outweigh any detriment that may arise from the public's perception that the depository may not be wholly separated from its affiliates.

Based upon the above, safety and soundness would be enhanced, not threatened, by allowing depository institution holding companies to engage in new activities.

QUESTION 2

The bill the Senate passed last year made some modest changes in the Glass-Steagall Act. I know the Administration has strongly supported those changes, but I wonder what the Administration's attitude is toward a more fundamental change in Glass-Steagall?

ANSWER

As I said at the hearing, the Glass-Steagall Act's separation of commercial banking from the securities business has served a useful purpose and we are not suggesting that it be eliminated immediately. What we are urging is that Congress enact certain selective exceptions to it where there is no evidence of undue potential risks. We then can evaluate the banking industry's experience with these new activities and their impact on the banking system and the financial services industry and later take additional steps if appropriate.

QUESTION 3

The commercial loan market has been "securitized" through the development of commercial paper. The mortgage loan market is being "securitized" through the development of mortgage backed securities. Some are starting to securitize automobile loans.

Do you agree with the forecasts of increasing "securitization" of loan markets? If so, what will this imply for the structure of financial institutions?

ANSWER

James M. McCormick of First Manhattan Consulting Group, testifying before the Committee on May 15, 1985, stated that legislation is needed to give banks the flexibility to evolve into more efficient intermediaries by offering securitized products rather than deposits and loans. He argues that securitization is more efficient than banks' traditional "balance sheet intensive" formula for financial intermediation because less regulatory equity is required and consequently spreads are thinner. This reduces the borrowers' cost of funds and increases investors' yields. He claimed that by converting loans to securities, banks can free up 140 basis points of cost and use their equity for other purposes. In addition, they can compete more effectively for large depositors and high-quality borrowers who have been attracted away from banks by securitized products offered by the securities industry. In the long run, he concludes, elimination of this constraint will increase efficiency, foster innovation, and enhance safety and soundness.

We believe these arguments merit serious consideration and intend to study them further.

QUESTION 4

Do you believe it is appropriate to deny an application for a bank or thrift charter or federal deposit insurance based on the regulator's determination that there is no need for the institution's services in its community?

ANSWER

Under the Community Reinvestment Act ("CRA"), federal regulatory agencies are required to consider whether an institution would meet the credit needs of the community in evaluating federal charter and insurance applications. For FDIC insurance purposes, there is also a specific requirement that the convenience and needs of the community to be served be considered. Therefore, meeting the credit needs of the community, which includes an evaluation of the need for the institution's services in the community, should be a consideration in any such application, but new statutory provisions to that effect would not appear to be necessary.

The Vice President's Task Group included a recommendation to exempt from the CRA smaller institutions with less than a specified amount of assets. We support this recommendation.

QUESTION 5

To what extent, if any, do you think federal regulators should be able to restrict powers granted by state legislatures, particularly in light of our longstanding reliance upon a dual system of federal/state regulation of financial institutions? Would the Administration favor treating all powers of state chartered institutions as higher risk activities for the purposes of risk related premiums?

ANSWER

The dual banking system has served the financial system well, as I indicated in my prepared testimony. Nevertheless, continuing to allow the states unfettered control over activities of institutions whose deposits are insured by federal agencies and whose financial viability is ultimately backed by Congress creates potential problems that should not be ignored. The Federal Government is ultimately responsible for the risks that federally-insured, state-chartered depository institutions undertake.

The chartering states often have no financial responsibility for the safety and soundness of these institutions. This arrangement could lead to a competition among the states to authorize more liberal activities. This raises a substantial question as to whether Federal standards should govern the appropriate activities of all federally-insured depository institutions. It may well be that greater recognition of federal standards can be achieved without unduly infringing on states' rights and the dual banking system.

The Administration has not yet determined what form of risk related deposit insurance premium structure it would favor but at this time we would think that activities authorized by the states should be judged for appropriate premiums based on their merits and not on the mere fact that they were state approved.

The Administration continues to support the expansion of products and services, including those in your banking bill as well as sponsorship of mutual funds and activities of a financial nature, offered by banking organizations. However, such activities should be performed through the holding company rather than through federally-insured depository institutions.

QUESTION 6

One of the components of the qualified thrift lender test in last year's S. 2851 was a limited credit for mortgages that were originated and sold in the secondary market. This credit has been criticized by the Federal Reserve, however. Given the housing-related nature of the test, and the undeniable contribution to housing made by mortgage-banking-type thrifts, do you see any problem with including such a credit in the text?

ANSWER

We did not oppose the provision in S. 2851 to allow 50 percent of the residential mortgages and related investments originated by a thrift institution and sold within 90 days to be used to meet the qualified thrift lender (QTL) test, up to a limit of 10 percent of the institution's assets. However, the Treasury believes that in the interest of competitive equity the exemptions for QTLs should be kept as narrow as possible and essentially be tied tightly to residential real estate lending.

QUESTION 7

The qualified thrift lender test has been regarded (by the Federal Reserve, at least) as a way of ensuring that, once the nonbank bank loophole is plugged, the separation of banking and commerce will not be compromised by the ability of general corporations to acquire non-housing-committed thrifts. The version of the QTL being considered in the House, however, would have consequences other than just in the holding company area -- specifically, those failing the test not only would have diminished authority at the holding company level, they also would lose their commercial lending power and their ability, if they were state-chartered institutions, to conduct activities not permissible for federal associations. It must be emphasized that these latter two sanctions would occur regardless of whether the depositories involved had any connection with a holding company. Do you think it is appropriate to use the QTL test, designed with the separation of banking and commerce in mind, in a non-holding company context?

ANSWER

We would not support the provision in the House bill (H.R. 20) which would remove from institutions that did not pass the QTL test the right to make commercial loans and the right to conduct activities not permissible for federal associations. This action seems designed to discourage thrifts from expanding into more bank-like activities.

The Administration believes that all depository institutions should ultimately be put on an equal competitive footing. Many of the current problems facing thrift institutions are largely the result of prior government attempts to structure an industry by statute in ways that were not economically feasible. We believe all depository institutions should have equal powers and should be free to choose whatever specialization they wish, based on their individual competitive skills and goals.

Answers to Questions Submitted by Senator Mattingly

QUESTION 1

Mr. Secretary, I am confused somewhat about your attitude towards the dual banking system which has existed in this country for well over 100 years. At one point in your statement, in criticizing the amendment to S. 2851 offered by Senator Dodd and adopted last year by the Senate, you refer to that action as "an unnecessary encroachment on the dual banking system, which is a vital source of innovation and dynamic competition" (top of page 4). But you also urge Congress to act now to remove what you describe as confusion in the financial services industry so that "state legislative initiatives" do not "cause further fragmentation of the financial system" (second-to-the last paragraph, page 2). And specifically you urge the Congress to enact legislation providing for nationwide interstate banking, I assume without regard to what individual states feel about that issue. If individual states believe it is their best interest to limit entry by out-of-state banks, why should their decision in this matter not be allowed to prevail?

ANSWER

You essentially are asking for our views on states' rights in the context of (1) the Dodd amendment, (2) preemption of other state-authorized activities, and (3) interstate banking. First, we object to the Dodd amendment not so much for states' rights reasons as the fact that it is designed to protect only the home state's insurance industry. We do not believe that arguments favoring the restriction of states' rights should be used to support a proposal that unequally benefits a single industry. Second, as I indicated in response to Chairman Garn's fifth question, adopting Federal standards based upon risk assessments of activities of state-chartered, federally-insured depository institutions merits serious consideration because the Federal Government is ultimately responsible for the risks that these institutions undertake. Finally, under the interstate banking proposals we are supporting, the decision to participate or not is up to the individual states. They can opt out by foregoing regional compacts.

QUESTION 2

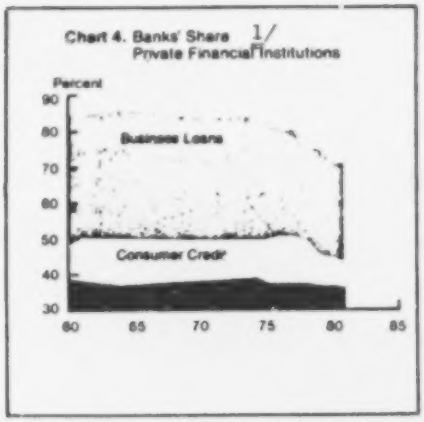
Mr. Secretary, on page 3 of your testimony you say that by allowing banks to offer new products and services they will be able to compete for customers on an equal basis with less regulated firms, thereby stemming the erosion of their customer base. Has the Department of Treasury or any other federal department or agency, made any study or conducted a survey to determine the extent to which there has been an erosion of the customer base of our depository institutions? Are there, in fact, fewer depositors and borrowers utilizing the services of our depository institutions than there were three, five or ten years ago?

ANSWER

The critical point is that the changing nature of the financial services industry and the growth of diversified financial services firms have given both depositors and borrowers a much broader array of potential providers for services traditionally offered by depository institutions.

Although banks and thrifts have been able to expand into some new services, they have not been able to achieve the same degree of diversification as have other financial services firms. Specifically, securities firms, investment companies, insurance companies, real estate firms, and retailers now offer all the products available at depository institutions, while banks and thrifts are still excluded from the core product areas of these firms.

The expansion of other diversified financial services firms into traditional banking areas has been one factor contributing to a decline, as evidenced by the following chart, in commercial banks' share of business loans, consumer credit, and the financial assets held by all private financial institutions.



In light of the expansion of other financial institutions into the banking area and the declining market share of banks, we believe that an expansion of bank and thrift holding company product powers is a critical step in enabling depository institutions to compete on an equitable basis for customers.

QUESTION 3

I am somewhat surprised by the statement you make that "there are virtually no banking-type products or services that the securities and insurance industries cannot offer their customers." Can securities firms and insurance companies offer federally insured checking accounts and make commercial loans? Can they provide letters of credit?

ANSWER

By acquiring a savings and loan association, securities firms and insurance companies can offer federally insured checking accounts and make commercial loans through a single entity. Savings and loans are, admittedly, somewhat limited in the extent to which they can offer both of these services. However, by utilizing separate subsidiaries or affiliates to provide these services, securities firms and insurance companies can offer both products on a broad scale.

1/ Donald L. Koch, "The Emerging Financial Services Industry: Challenge and Innovation," Economic Review, Federal Reserve Bank of Atlanta, April 1984, p. 28.

The acquisition of nonbank banks in which the commercial loan portfolios have been divested opens the door for the offering of federally insured checking and deposit accounts. Merrill Lynch and Dreyfus Corporation are two examples of firms that have already acquired FDIC-insured nonbank banks.

Through other subsidiary endeavors, these firms are able to provide a wide range of commercial loans. As of year-end 1983, Prudential Insurance was the fourth largest provider of commercial loans in the country, with $29.8 billion of outstanding commercial loans. 1/

Securities firms and insurance companies do not offer letters of credit per se. However, letters of credit are really a subset of the larger field of financial guarantees, which also includes such items as insurance bonds. A number of securities firms and insurance companies are very significant participants in the burgeoning field of financial guarantees, 2/ and they thus do offer a very broad range of banking-type products.

QUESTION 4

Mr. Secretary, you stress in your testimony that the safety and soundness of our financial system must be our highest priority. I am sure no one disagrees. But I think you will find disagreement on whether the vitally important goals of safety and soundness will be enhanced by allowing bank holding companies the authority to engage in securities, insurance and real estate activities. You suggest that the holding company structure, whereby these risk activities are conducted by non-banking affiliates, does not increase the risk exposure of the federal deposit insurance funds. However, let me quote to you what two experts have said on this subject and then I'd like your comments.

First, Walter Wriston, who while testifying before this Committee, with regard to the effect of the failure of a holding company affiliate, stated:

> If your name is on the door, all of your capital funds are going to be behind it in the real world. Lawyers can say you have a separation, but the marketplace is persuasive, and it would not see it that way.

1/ American Banker, January 4, 1985, p. 8.

2/ American Banker, June 24, 1985.

And Chairman Paul Volcker, again in testimony before this Committee, about the efficacy of the separate affiliate concept, said:

> We also believe that these concerns, must to a degree encompass business organizations of which banks are a part -- that is, bank holding companies -- for the basic reason that a bank or depository institution cannot be wholly separated from the fortunes of its affiliates and from the success or the failure of their business objective.

Can you assure me that if we experienced a series of failures of the securities, insurance or real estate affiliates of major bank holding companies that this would in no way adversely affect the safety and soundness of our financial system or adversely affect our federal depository insurance funds?

ANSWER

As I indicated in response to Chairman Garn's first question, on balance the benefits to bank and thrift holding companies of competitive equity with other multiproduct financial service firms substantially outweigh any detriment that may arise from the public's perception that the depository may not be wholly separated from its affiliates. Moreover, there are means to maintain a legal separation of these entities and to adequately apprise the public of such separation. Safety and soundness would be enhanced, not threatened, by allowing depository institution holding companies to engage in new activities.

QUESTION 5

There has been considerable discussion recently about the possibility of merging the FSLIC and the FDIC, a step not endorsed by the Vice President's Task Group. Would you favor such a consolidation, and why, or why not?

ANSWER

The Administration agrees with the Task Group's recommendation that the FSLIC and FDIC establish a uniform regulatory approach, including common accounting and minimum capital standards to be phased-in over time if necessary. This would make it easier to merge the insurance funds and agencies should it become appropriate. Merging the FSLIC and FDIC at this time could well be premature given the differences in both the financial condition and the nature of insured risks among the different types of insured organizations. The Task Group has reached the same conclusion.

Answers to Questions Submitted by Senator Proxmire

QUESTION 1

As you know, capital requirements for thrifts have been substantially reduced by lowering the rate from 5 percent to 3 percent and adopting regulatory accounting principles. As a result, many thrifts are operating today with no real capital.

° Would you favor giving the thrifts a statutory mandate to achieve a 5 percent ratio under generally accepted accounting principles by a date certain - say 5 to 7 years?

ANSWER

The Administration believes that a statutory mandate requiring thrifts to have a 5 percent capital ratio in 5 to 7 years would not provide the flexibility that the system needs. However, we support the Vice President's Task Group's recommendation that as thrift earnings improve, the FHLBB gradually establish a minimum capital level for thrifts that is similar to the one set for banks. It appears reasonable that common capital standards could be implemented within 7 years, however, the FHLBB should retain authority to vary the standard in the event of industry-wide financial difficulties.

The Bank Board has publicly stated its concern over the industry's deteriorated capital position, which resulted from the severe losses in 1981 and 1982, and has adopted regulations to strengthen the capital levels.

As the primary thrift regulator, the FHLBB is in the best position to know how quickly institutions can increase their capital and, therefore, what level of capital is reasonable to require. In addition, the Bank Board's responsibilities with regard to the FSLIC fund give it a strong incentive to increase the capital requirements of institutions as soon as possible. Therefore, we believe that establishing a statutory capital to asset ratio is not necessary at this time, although we would support a statutory mandate for equalizing the minimum capital requirements for banks and for thrifts.

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QUESTION 2

On page 6 of your statement, you indicate the need to consider extending deposit insurance premiums to cover foreign deposits. As you know, last year I introduced an amendment to S. 2851 extending the deposit insurance premium base to cover foreign deposits while reducing the premium rate from 1/12 of one percent to 1/15 of one percent. The effect of these two changes was revenue neutral.

* Would you favor this approach, or do you recommend that we include foreign deposits in the premium base while keeping the premium rate at 1/12 of one percent?

ANSWER

Although your plan slightly reduces the insurance premiums for thousands of small banks, it increases the costs for large international class banks and does not increase the size of the insurance fund. I think Congress and the Administration must consider (1) whether the benefits of this plan outweigh the competitive problems it will create in the international lending market, (2) to what extent the plan will strengthen the safety and soundness of the deposit insurance system, and (3) whether it is consistent with other Administration recommendations, such as risk-related pricing and increased capital. On balance, I suspect that measures such as increased capital levels and/or risk-related pricing might do more for advancing safety and soundness and protecting the insurance funds than would foreign deposit insurance assessments.

Answers to Questions Submitted by Senator Riegle

QUESTION 1

Paul Volcker when he last testified here urged us to clarify the powers of state banks and, in effect, to preempt state laws where necessary to prohibit activities authorized by states that are inconsistent with safe and sound banking practices.

He pointed to legislation adopted last year in California and New York to authorize real estate development activities and in Ohio to authorize investment in corporate equities as well as real estate development and he said that these activities pose "real threats" for the banks that engage in them.

* What is your reaction to the suggestion that Congress should more clearly delineate the activities state chartered financial institutions may and may not engage in?

* What specific activities do you think state chartered financial institutions should be permitted to engage in which are currently prohibited to nationally chartered institutions?

ANSWER

As I indicated in response to Chairman Garn's fifth question, as long as a state-chartered bank is federally-insured, the Federal Government is ultimately responsible for its insured deposits. Adopting federal standards for these institutions' activities merits serious consideration, provided that we are careful regarding the potential impact on the dual banking system.

QUESTION 2

Two weeks ago four Nebraska banks were closed and one in Arkansas as a result of weakness in the agriculture sector. These closings were cited as a reason for the decline in Treasury bill rates and a sharp rise in bond prices.

(a) What steps is the Administration currently taking to relieve the problems facing agriculture banks and farmers?

(b) How seriously do you view the problem of farm banks as it relates to the safety and soundness of our banking system?

ANSWER TO 2(a)

The Administration is currently trying to relieve the problems of agricultural banks and of farmers through programs managed by the Farmers' Home Administration, which benefit family-size farms; the Farm Credit Relief measures introduced in September of 1984 and strengthened in February of 1985, which encourage banks and other lenders to restructure farm debt; and the U.S. Department of Agriculture's emergency credit assistance program, which allows the Farmer's Home Administration to guarantee up to 90 percent of one year operating loans.

In addition the Department of the Treasury has worked with the FDIC, the OCC, and the FRB to reinforce long-standing policies to avoid supervisory actions that may discourage banks from working with farmers who are experiencing temporary difficulties in meeting debt service obligations.

ANSWER TO 2(b)

Although the problems of the farm banks are serious, the Administration believes they do not threaten the safety and soundness of our banking system. The regulators define agricultural banks as those whose agricultural loans comprise 25 percent or more of total loans. Almost 30 percent of the commercial banks in this country (about 4,100 banks) are agricultural banks. Their total assets are about $113.5 billion. The FDIC feels confident it can handle any agricultural bank failures in 1985 with no threat to the system.

The agricultural banks are generally more highly capitalized than their nonagricultural counterparts, and as such are in a better position to withstand loan losses. The capital to asset ratio of agricultural banks increased from 8.8 percent in 1980 to 9.0 percent at year-end 1983. While this amount of capital puts agricultural banks in a good position, the potential for losses has increased and this trend is likely to get worse. Therefore, the Administration is closely watching developments in this area.

QUESTION 3

It has been widely reported that almost 40 percent of all savings and loan institutions regulated and supervised by the Federal Home Loan Bank Board have either a negative net worth or a net worth under 3 percent and that the assets of the Federal Savings and Loan Insurance Corporation could easily be exhausted if a large thrift unit were liquidated.

(a) What specific steps, if any, do you think should be taken to deal with what many believe is a pending crisis in our thrift industry?

(b) How do you expect this industry to change within the next few years?

(c) Chairmen Isaac of the FDIC and Gray of the FHLBB have differing views as to whether their respective insurance funds should be merged. What is your view on the merging of the FDIC and FSLIC?

ANSWER TO 3(a)

The major step the Administration believes should be taken to prevent a crisis in our thrift industry is keeping inflation under control and thus continuing the decline in interest rates. As a result of the decline in interest rates over the past several years, the spread between the industry's average cost of funds and average mortgage portfolio yield changed from negative 1.09 percent in the first half of 1981 to positive 2.10 percent in the first quarter of 1985. Although the industry's ratio of net worth to assets was only 4.07 percent in May of 1985, continued low interest rates should enable most of the industry to significantly improve their net worth positions by the end of 1985. In addition, the thrift industry will have continued assistance through the net worth certificate program and emergency interstate and cross industry merger powers adopted in the Garn-St Germain Act, which have been extended by H.J. Res. 393 until April 15, 1986. Finally, the Administration believes the system can be strengthened through deposit insurance reforms.

ANSWER TO 3(b)

The Administration's financial institutions deregulation policy has been to provide depository institutions with expanded powers and allow them to specialize as they wish, based on their individual competitive skills and goals. Therefore, within the next few years we would expect some thrift institutions to choose to remain specialized in housing finance and others to choose to become more bank-like in their activities.

ANSWER TO 3(c)

The Administration agrees with the Bush Task Group's recommendation that the FSLIC and FDIC establish a common minimum capital level, to be phased-in over time if necessary, for institutions insured by their respective insurance funds. This would make it easier to merge the insurance funds and agencies sometime in the future should it become appropriate. We believe that merging the FSLIC and FDIC at this time would be premature given the differences in both the financial condition and the nature of insured risks among the differenct types of insured organizations.

QUESTION 4

Do you think our financial services regulatory agencies should be restructured in any major way and, if so, how would you propose restructuring them?

ANSWER

The Administration has proposed that certain initial steps be taken to restructure the regulation of financial services with an emphasis placed on the principle of regulation by function. The starting point proposed by the Administration is that found in the July 1984 study "Blueprint for Reform: The Report of the Task Group on Regulation of Financial Services." The major proposals of the "Blueprint" are outlined in the attached "appendix".

It is worth highlighting the fact that at this preliminary stage we are not recommending the elimination of any of the current federal banking agencies, although a streamlining of their regulatory responsibilities is suggested. Thus the Federal Banking Agency (FBA) would replace the OCC as a Treasury Department agency and would assume all of the duties of the OCC with respect to regulating national banks; all state chartered banks would be regulated by the Federal Reserve Board; and the FDIC would no longer be involved in the regulation, examination and supervision of state non-member banks (concentrating instead on its responsibilities as an insurer of deposits). In addition, most bank holding companies would be regulated by the primary regulator of their lead bank. While by no means extreme, these measures would result in a more logical realignment of bank regulatory responsibilities than we have currently.

With respect to thrift institutions, the "Blueprint" does not recommend any changes be made in regulatory structure. However, it is recommended that institutions that wish to retain the Federal Home Loan Bank System as their regulator should be better "defined" as thrifts. This would be done by having such institutions meet the standards of a "qualified thrift lender". Thrifts that did not meet the test would be required to secure FDIC insurance and be regulated as banks. Again, the emphasis is on a modest measure that logically distinguishes banks from thrifts and bank regulation from thrift regulation.

Other recommendations would reform the deposit insurance system, transfer more responsibility to state regulatory agencies that meet certain qualifications, streamline controls and eliminate or repeal unnecessary regulations and legislation.

In summary, it is my opinion that the "Blueprint for Reform" provides us with a reasonable starting point for the serious and difficult task of modernizing the regulation of our financial system.

QUESTION 5

When does the Administration plan to fill the vacancies and appoint a new Chairman of the FDIC and Comptroller of the Currency?

Can you give us any idea of names under consideration for these positions?

ANSWER

The Administration is well into the process of filling vacancies in offices with responsibility for financial institutions matters. The nominations of Mr. George D. Gould as Under Secretary of the Treasury, Mr. Charles O. Sethness as Assistant Secretary of Treasury for Domestic Finance, and Mr. Robert L. Clarke as Comptroller of the Currency have been made. In addition, Mr. L. William Seidman already has been confirmed as Chairman of the FDIC.

QUESTION 6

Sears Roebuck and Company is urging us to allow them to enter the banking business by establishing consumer or family banks.

* What are your views with respect to the Sears proposal and regarding the prospect of nonfinancial companies getting into banking?

ANSWER

We are concerned about the competitive impact of the consumer bank proposal. A consumer bank exception at this time would permit diversified financial and nonfinancial service firms like Sears to add federally-insured deposits to their product line while traditional bank holding companies would remain subject to the separation of banking and commerce. In addition, a consumer bank exception could eventually lead to eliminating the separation of banking and commerce.

We therefore support legislation to subject all FDIC-insured banks to the BHC Act with no special exception for consumer or family banks, provided that the legislation includes provisions to expand the authorized activities of bank holding companies.

QUESTION 7

This is the fourth year in a row that the Administration has presented us with virtually the same testimony on banking legislation. Putting aside your big picture of a one-stop financial shopping center for a moment and recognizing that life is a matter of alternatives and priorities, what are your top priorities in this area?

Is it plugging the non-bank bank loophole?

Is it deposit insurance reform?

Is it providing the banks with additional securities powers? insurance powers? real estate powers?

Is it closing the South Dakota loophole?

Is it following up on the Bush Task Force recommendations to restructure our bank regulatory agencies?

ANSWER

The priorities of this Administration with respect to the reform of financial institutions and markets were established a number of years ago and remain essentially unchanged today. As early as 1981 the Administration established an agenda that called for (1) deregulation of deposit interest rate ceilings at the earliest possible date, (2) expansion of bank-like services performed by nonqualified thrifts to enable those institutions to better manage interest rate cycles, (3) expansion of the product powers of bank holding companies to enhance the

ability of banking organizations to compete against diversified non-regulated financial firms, (4) liberalization of geographic restrictions on banks, (5) reorganization of the regulatory structure, and more recently (6) deposit insurance reform.

As you know, deposit interest rate deregulation has largely been accomplished and the nation's thrift institutions gained significant new service activities in the 1982 financial reform legislation. Recently, the Supreme Court has endorsed regional interstate banking compacts. We believe Congress should turn its attention to development of a trigger mechanism for full interstate banking, but we would not hold up progress on the other outstanding issues solely for this reason.

Most important is the need to provide depository institution holding companies with expanded product authority as I indicated in my statement of June 13. Again, the minimal powers should include those proposed in S. 2851 -- i.e., underwriting and dealing in municipal revenue bonds, commercial paper and mortgage backed securities -- as well as authority to sponsor, distribute and advise mutual funds and authority to engage in activities "of a financial nature" as determined by the Federal Reserve.

With respect to the "nonbank bank" and other "loopholes", I want to reiterate my position that the proper response to concerns about such "loopholes" is comprehensive legislation. Any such "loophole" closing legislation should be combined with provisions to expand products and services offered by bank organizations.

Clearly, another important issue which requires careful consideration at this time is deposit insurance reform. The FDIC and FHLBB have made specific proposals that deserve close attention in addition to the proposals of a number of other recent studies.

Appendix

The Major Proposals of the Blueprint for Reform

1. The three existing federal bank regulators would be reduced to two by eliminating the FDIC's role in examining, supervising and regulating state non-member banks. A new "Federal Banking Agency" ("FBA") would be created within the Treasury Department, incorporating and upgrading the existing OCC. This agency would regulate all national banks, while the FRB would be responsible for federal regulation of all state-chartered banks.

2. The regulation of bank holding companies would be substantially reorganized. At present, the FRB regulates all bank holding companies, even though a different agency usually regulates the subsidiary bank(s) of the holding company. Under the new system in almost all cases the agency that regulates a bank would also supervise its parent holding company. This would make it possible for most banking organizations to have a single federal regulator rather than two.

3. The FRB would transfer its authority to establish the permissible activities of bank holding companies to the new FBA, although it would maintain a limited veto right over new activities.

4. The FRB would continue to supervise the holding companies of the very largest domestic banks, as well as those with significant international activities and foreign-owned institutions.

5. The FDIC would be refocused exclusively on providing deposit insurance and administering the deposit insurance system. All its current responsibilities for environmental, consumer, antitrust and other laws not directly related to the solvency of insured banks would be transferred to other agencies, as would its responsibilities for routine examination, supervision and regulation of state non-member banks. At the same time, the FDIC would assume new authority to review issuance of insurance to all institutions, as well as to examine all troubled institutions and a sample of non-troubled firms in conjunction with the primary supervisor. The FDIC would also have new authority to take enforcement action against violations of federal law concerning unsafe banking practices in any bank examined by it where the primary regulator failed to take such action upon prior request of the FDIC.

6. A new program would transfer current federal supervision of many state-chartered banks and S&Ls (and their holding companies) to the better state regulatory agencies, creating new incentives for states to assume a stronger role in supervision.

7. The special regulatory system for thrifts would be maintained, but eligibility would be based on whether an institution is actually competing as a thrift, rather than on its type of charter.

8. The FDIC and FSLIC would be required to establish common minimum capital requirements and accounting standards for insurance purposes.

9. Antitrust and securities matters would each be handled by a single agency rather than five different agencies at present.

10. Some specific regulatory provisions would be simplified to eliminate unnecessary burden. These include existing legislative provisions that encourage wasteful litigation, as well as outdated application requirements in various areas.

THE
CONSUMER
BANKERS
ASSOCIATION

an association for the
retail banking professional

October 28, 1985

The Honorable Jake Garn, Chairman
United States Senate
Committee on Banking, Housing
and Urban Affairs
Washington, DC 20510

Dear Senator Garn:

On behalf of the Consumer Bankers Association, I am pleased to respond to your written questions following my testimony before the Committee earlier this year.

As you know, the CBA represents federally-insured retail financial institutions. As such, we have attempted to respond to those questions with which we have some familiarity or expertise. In a few instances, we have declined to answer if we have no position.

Also, for convenience, you will find all questions numbered in sequence. If submitted by another member of the Committee, we have indicated that Senator in parentheses.

Once again, we appreciate the opportunity to testify before the Committee, and hope our comments are helpful to you.

Sincerely,

William J Stallkamp JD

William J. Stallkamp

Question #1: In your opinion, is the continued blurring of the lines between banking, insurance, and securities inevitable? Why?

Without a doubt, the financial services industry is being redefined, reorganized and expanded at a rapid pace.

Traditional lines between different segments are either disappearing or being rearranged by market forces. This phenomenon is inevitable for several reasons.

The deregulation of interest rates on savings instruments has afforded consumers new opportunities for return on investments. This is healthy and a desirable result. Consumers, once restricted in the variety of savings and transaction instruments available to them, now have a wider choice of such instruments with market rates of return. As is often noted, even by the detractors of rate deregulation, "it is impossible to put the toothpaste back in the tube." Once removed, Reg Q would be difficult if not impossible to reimpose. It follows that as consumers become attuned to competition over rates, they will also begin weighing features of instruments, as well as price. The providers of financial services, which already include both banks and non-banks, will continue to evolve more sophisticated products, combining aspects of different industries' products wherever possible and whenever consumer and market demands dictate.

In addition, technology and rapid information flow will continue to drive the financial market toward a realignment. For reasons of convenience, consumers have embraced automated teller machines, credit cards, on-line information services, and other automated financial services. Just as new products are developed and offered, new means of obtaining and accessing these products are being developed.

Question #2: Many analysts claim that commercial and personal loans are in the process of being "securitized." They point to commercial paper, mortgage backed securities, auto loans, and junk bonds. Do you agree?

The above statement is true. The secondary market, however, has existed for a long time and the recent trend has simply expanded the types of securities available in that market. Though "Fannie Mae" bought and sold FHA mortgages as early as the late 1930's, the secondary mortgage market began to contribute significantly to capital market flows in the mid-70's. Then the upward trend in,and volatility of, interest rates forced the federal government to remove impediments to free access to the capital market. /1 Increased activity in mortgaged-backed securities helped to alleviate some of the problems caused by high interest rates and disintermediation in the national primary market.

Recently, financial institutions have become more involved in the packaging and selling of securitized auto loans. There are some regulatory issues that are unclear and that have hampered the widespread availability of these securities. Despite the problems, financial institutions remain interested in the area because securitized assets permit them to address cash flow uncertainties and therefore better manage their portfolios.

1/ Favozzi, F., The Handbook of Mortgage Backed Securities, (1985) p. 13.

Question #3: In his testimony, James McCormick, President of First Manhattan Consulting, indicated that capital and reserve requirements coupled with having to pay market rates on deposits is beginning to make the traditional bank profit formula obsolete. Do you agree? Why or why not? Yes.

The question of earnings formulation in the commercial banking system has been greatly complicated by deregulation. Previous to deregulation, bank strategy maximized the net interest margin in order to bring leveraged earnings to an adequate return on equity to attract capital to the industry. With deregulation came an almost certain decline in the net interest margin leaving banks to either increase fee income or increase leverage.

The unstable environment created by deregulation has caused the public, as reflected through Congress, to become more and more concerned about safety and soundness issues in the industry, which argues against additional leverage. This has occurred despite some concern regarding non-paying club members such as Merrill Lynch, American Express, and Sears which operate with substantially lower capital ratios and thereby leverage substantially higher. The banking industry is faced with reducing burden and increasing fee income as an alternative to increased leverage. Cost savings are difficult to tie down although the consolidation of the industry probably lessens them. Consequently, the only viable method of assuring bank industry participants an adequate return on equity while maintaining capital ratios necessary to maintain safety and confidence in the system is to provide additional fee income. Obviously, the most appropriate method of doing that is to allow banks to send more products down the established delivery system. Those products should include insurance, brokerage services, and other products and services.

Question #4: Why should banks and thrift holding companies be given the authority to underwrite and distribute mortgage backed securities, particularly in light of Bank of America's problem in this area?

As we noted in our answer to Question #3, "securitized" instruments permit banks to address cash flow uncertainties and to better manage their portfolios. Furthermore, mortgage backed securities in particular have played a significant part in the capital market since the 1970's. As a result, financial institutions have developed an understanding of the secondary market.

Bank of America's recent problems were not directly related to its distribution of mortgage backed securities. Rather, the bank had been in the positions of trustee and escrow agent and the cause of the problem was a fraud that is being addressed in the courts.

Question #5: The legislation which passed the Senate last fall provided for a very modest expansion in the range of services that banks could offer their customers, but it was a step in the right direction. If banks are not authorized to broaden the services which they can offer:

a. What will be the impact on banks' ability to maintain expensive brick and mortar facilities for the convenience of consumers.?

b. What will be the impact on the ability of the industry to raise capital and what will be the impact on the riskiness of the industry?

Though estimates vary, a typical bank's branching system was built to operate on a 400 basis point spread. The recent and substantial modifications to the Regulation Q subsidy, especially the Money Market Deposit and Super NOW Accounts, have drastically changed the cost structure of retail banking. As it is estimated that the spread on new accounts varies between 25 and 125 basis points, the branching system, as it has existed, cannot survive in this environment. Financial institutions have pursued a number of avenues to remain profitable. They have priced their products and services to realistically reflect costs. They have streamlined their branching operations and automated services and internal functions.

Cost reduction measures have resulted in more efficient and economic banking services. However, financial institutions must continue to meet the demands of a competitive market composed of entities that are permitted to offer a broader array of services that contribute to their profit margin.

As long as regulated financial institutions are restricted to products and services that provide a slim profit margin, they will have to continue to cut costs. As branching operations are very expensive, they will continue to be a logical target of expense reductions. There will be more branch consolidations, closings and a reduction of hours. Branches provide benefits for both the customer and the institution; convenience and personal attention to the consumer, and institutional identification and loyalty for the bank. If banks cannot offer more products and services they will ultimately have no choice but to substantially decrease their branch operations.

Question #6: Given the present state of state ATM laws, what would be the effect of the passage of S.1148 on shared ATM networks? What federal legislation on ATM networks do you recommend? Why?

Passage of S.1148 would cause substantial changes in the present operations of ATM networks and it would also severely hamper the future development of shared systems.

At present, ATMs owned or shared by national banks are regulated by the Office of the Comptroller of the Currency (OCC). OCC regulations and interpretative letters provide the framework for application procedures, capital requirements, and shared arrangements.

S.1148, in applying state law to ATMs, would add another layer of regulation and most likely, in some instances, conflicting requirements for national banks that will also continue to be regulated by the OCC.

State regulation may prove to be unnecessarily burdensome. For example, many state-wide and regional networks are now entering agreements that will permit the customers of all of the participating institutions to access all of the ATMs in the interchange. These agreements involve institutions that are located across state lines. There are states that require that all banks which wish to participate in a shared network complete extensive application procedures before they can provide the service. Currently, national banks must notify the Comptroller of their participation. S.1148 would require national banks to comply with both federal and state law. This could prove to be unnecessarily burdensome. Those states with comprehensive application requirements would be deluged with information from potentially hundreds and even thousands of additional banks. This would be particularly true for nationwide ATM systems. On the other hand, national banks that participate in interstate systems would be faced with the expensive and time-consuming burden of complying with a myriad of state requirements.

The systems now operate efficiently and economically. An additional layer of complex, contradictory or confusing laws and regulations would reduce the very economies of scale and convenient services that have contributed to the success of the networks. At the same time, there appears to be no supervisory benefit to the regulators who will be overtaxed; to the consumers who may not be able to use as many ATMs because institutions will most likely avoid states with onerous requirements;

or to the banks that will incur additional compliance and operational costs.

In our testimony we outlined other concerns that CBA members have with S.1148. The broad scope of many of the terms such as "constructive use" would create uncertainty and inhibit future development. In fact, legitimate arrangements that now exist may be illegal under S.1148.

The provisions requiring uniform fee schedules and mandatory sharing would also create unnecessary problems and potentially inhibit further growth.

If Congress believes that it is necessary to enact legislation, S.206 is most appropriate. It codifies the present OCC regulations that national banks have relied on for nearly a decade. It would permit the systems to continue to develop and provide the services that are obviously benefitting consumers.

Due to the technological nature of the systems, however, any amendments to S.206 could cause a multitude of problems and could ultimately inhibit shared ATM development. As a result, we would recommend enactment of S.206 but only without any amendments.

Question #7 (submitted by Senator Sasser): You argue that banks should be able to get into the insurance business. Are you aware of any undue concentration in the insurance industry that would suggest that bank entry is likely to provide better products or lower costs?

While neither the insurance nor the banking industries can be classified as "unduly concentrated", the insurance industry is more concentrated than the depository industry. There are less that 5,000 insurance companies compared to more than 18,000 commercial banks and thrifts. As the attached chart shows, the top ten life insurance companies account for half the total assets of their industry and the top ten property and casualty companies have more than a third of the assets of their industry. However, the top ten commercial banks have only 20% of total industry assets.

Bank entry into insurance will benefit consumers in terms of better or more products, more convenience and lower costs, as new market entrants effectively compete with traditional insurance providers. In addition, the economics of the business demonstrate that insurance may be delivered to consumers less expensively via bank branches and other locations than through insurance agents. This translates into lower cost insurance for the public.

We concur with the Department of Justice that stated that:

> Permitting banking organizations to offer a wider variety of financial services would enhance competition in the markets for those services, directly benefiting consumers. It would also enhance the ability of the firms to remain viable competitors in the evolving financial services marketplace. (Comments to the FDIC dated November 14, 1983)

COMPARATIVE INDUSTRY CONCENTRATIONS

10 LARGEST FIRMS' SHARE OF INDUSTRY TOTAL BASE

Concentration Rank	Industry	No. of Companies	Top 10 Share of Total Industry	Base	Total Base ($ Billions)
1.	Securities Industry	339	54.4%	Capital	$11.6
2.	Life Insurance Cos.	2,060	50.2%	Assets	$588.2
3.	P&C Insurance Cos.	2,953	34.5%	Assets	$251.2
4.	Savings Banks	424	29.5%	Assets	$174.2
5.	Commercial Banks	14,452	20.3%	Assets	$1,876.1
6.	Savings & Loans	3,342	13.1%	Assets	$686.2

Sources:

Life Insurance Fact Book
A.M. Best
NAMSB National Fact Book
FDIC
FHLBB

Question #8 (submitted by Senator D'Amato): The Glass-Steagall Act was viewed by its proponents as an integral part of the effort to restore the public confidence in the banking system after its collapse in 1933 and to protect depositors by insuring the stability of commercial banks. In particular, the Act's substantial separation of commercial and investment banking was designed to eliminate the problems and abuses congress believed were associated with commercial banks' securities activities.

Do you believe the Act was too sweeping and that the problems it was meant to solve could be addressed with other legislation? Would this enhance the banking industry? Would the consumer benefit?

Question #9 (submitted by Senator D'Amato): Those who oppose the affiliation of banks and securities firms maintain that conflicts of interest resulting from such affiliations justify the preservation of the Glass-Steagall Act. Banks have long faced potential conflicts of interest. Particularly between their commercial lending and trust activities. Securities firms face comparable potential conflicts in their various roles as underwriter, broker, dealer, and investment advisor.

Do you believe that divorcing the two, because of potential conflicts, imposes unnecessary costs on society?

Questions 8 and 9 are based in large part on two assumptions that are subject to far more debate and continuing uncertainty than the questions would imply. The first assumption is that the Glass-Steagall Act was primarily aimed at eliminating abuses associated with commercial bank securities activities. The second is that the Act erected a total and inviolate wall between commercial and investment banking to achieve this end. A review, however, of the Act's legislative history and the actions of the regulators, courts and commercial bank trust units in chipping away at the cracks in these assumptions over the last 30 years paints a different picture. Moreover, such a review may indicate that these very assumptions have unnecessarily cost the consumer valuable benefits by limiting the competitive opportunities open to the banking industry.

Over the last 20 years, the banking and securities industries have "debated" the meaning of 5 sections of the Act which do indeed address the barriers between commercial and investment banking. However, the remaining 29 sections of the Act created the Federal deposit insurance system and Federal Open Market Committee and prohibited the payment of interest on checking accounts, thereby leading some to

suggest that the Act's focus on securities activities was less than complete.

The legislative history of the Act supports this view. Representative Steagall of Alabama had little interest in anything other than the deposit insurance aspects of the legislation. /1 The Act appears to have passed both houses in the 73rd Congress without reference to the "general" obligation bond limitation which, upon reappearance in the conference report (contrary to the rules of both bodies), has come to represent a congressional intent to limit bank underwriting powers. /2 Amendments effectively making the Act applicable solely to member banks were passed in 1939. Finally, the slow pace of the legislative process which took more than two and a half years to produce the Act, belies the common characterization of a congressional preoccupation with the imminent collapse of our financial system due to bank securities activities.

Over the last quarter century, there has been a veritable parade of regulatory and judicial determinations as to the exact barriers that Act imposed between commercial and investment banking. This parade bears further witness to the less than precise or total wall which Congress actually constructed. In terms of the wasted commercial resources and lost opportunities which it has absorbed, this parade has also come to represent something less than a fair and efficient method of limiting the abuses the Act sought to address. /3

In large part, these concerns appear to have been more efficiently and equitably addressed by the regulatory safeguards applied to commercial bank trust operations. /4 The very existence of such activities as an integral part of the commercial banking business constitutes evidence of something other than a congressional intention to totally ban bank underwriting and investment management activities. This is not because they do not contain the potential for some or all of the abuses and dangers to bank solvency

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1/ Bevan, R.L. "June 16, 1933 - You Are There As Glass-Steagall Is Born" United States Banker, May 1985, p.29.

2/ Id.

3/ Fischer, Gram, Kaufman and Mote, "The Securities Activities of Commercial Banks: A Legal and Economic Analysis" 51 Tenn. L.R. 467 (1984)

4/ Id. p. 504 - 05.

attributed to bank securities affiliates during the Glass-Steagall debates. /5 Rather, their continued existence and record of success suggest that the regulatory safeguards on trust activities which were evolved to address these concerns have proven sufficient. They have also proven far more efficient and equitable than the stuttering, stop-and-go parade of administrative and judicial decision-making occasioned by the policy vacuum created by congressional inaction.

Measuring the lost consumer benefits and banking opportunities resulting from the congressional segregation of commercial and investment banking is in large part a guessing game. Measuring the efficacy with which Congress has addressed these concerns is a less uncertain matter. The costs have outweighed the gains.

5/ Id.

Question #10 (submitted by Senator D'Amato): In recent months there has been a growing number of bank failures throughout the nation. In some states entire bank systems have come under suspicion. It seems each time a small bank faces financial trouble, a large out-of-state bank moves in. When an entire system fails, as was the case in Ohio, large interstate banks move in to straighten out the situation.

For all practical purposes, interstate banking is proceeding, despite the lack of congressional action on the subject. I am hoping that as financial experts you could provide additional insight into this matter. Do you believe consumers will benefit? Will interstate banking provide safer banking?

On April 25, the Comptroller's office said the following about consumer benefits from interstate banking:

> "We believe bank customers would benefit from increased competition. The removal of geographic barriers to bank expansion would be especially beneficial to consumers and small businesses. Unlike large corporations and wealthy individuals who often can purchase financial services from a nationwide market, lower and middle income households and small business are generally limited to the financial services of local institutions. Full interstate banking should expand the range of products and services available to these customers. The experience in branch banking states compared to that in unit banking states demonstrates, we believe, the benefit of more permissive geographic expansion law. Statewide branching has led to the availability of a wider range of services for local communities. Furthermore, the banks that operate statewide consistently employ a greater proportion of their deposits for loans. We are aware of no evidence to support claims that banks use their branches to transfer funds to head offices in urban areas. Rather, banks transfer funds among their offices as dictated by demands for credit."

On April 25, the Federal Deposit Insurance Corporation's representative addressed the safety and soundness aspect of interstate banking in the following manner:

> "As the deposit insurer, one of our major concerns relates to the effects of interstate banking on safety and soundness of individual banks

and of the system as a whole. As indicated earlier, geographic expansion would afford the opportunity to diversify and reduce risks. Although the benefits of geographic lending diversification should not be disregarded, perhaps the most significant risk reduction for many banks to rise from building a more stable retail deposit base. This may mean that an increased number of banks compete for a relatively fixed amount of retail deposits in local markets that could result in reduction in the extreme funding vulnerability of a few institutions. Another concern relates to the danger that banks or bank holding companies may be willing to pay an unjustifiable premium to gain an early entry into selected markets. While mistakes undoubtedly will be made, the need to capitalize acquisitions and the accounting treatment of premiums paid, should provide a significant deterrent to unwise decisions.

Perhaps the greatest risks to the insurance fund of interstate banking emanates from the probable increased number of large banks and the potential for a significantly increased size of the largest banks. The statutory, and more importantly, the practical restraints placed on the FDIC normally mean that larger failing bank situations are more difficult to handle than small to-moderately-sized banks, and can result in a proportionately larger exposure to loss. However, in a world of interstate banking, there probably would be a larger number of eligible potential acquirers which may more than counterbalance the negative effects of the greater number of large institutions."

CBA concurs with these statements.

Question #11 (submitted by Senator Proxmire): You have raised a number of technical issues with regard to my bill on ATM terminals, most of which I think can be resolved. But I have a feeling we still disagree on the basic issue. You apparently believe that national banks should not be subject to any state laws on ATM terminals. This would give national banks a substantial competitive advantage over state banks contrary to the basic principles of the McFadden Act and the dual banking system.

* Why do you believe national banks should not be subject to state laws on ATM terminals?

We would like to clarify our position relating to the statement that " ... national banks should not be subject to any state laws on ATM terminals." As you know, there are two types of ATMs at issue. A proprietary ATM which is owned and operated by one institution is different from a shared ATM which belongs to a network that permits customers of more than one institution to use the ATMs that are part of the network.

A proprietary ATM is, in fact, a branch and subject to state branching laws. Whether and to what extent states should regulate both brick and mortar branches and proprietary ATMs are questions that should be considered in the context of interstate banking. CBA theoretically supports the nationwide deployment of proprietary ATMs as a step to nationwide banking, but its technical application vis-a-vis federal and state regulation has not been discussed in depth because of the general opposition to nationwide banking.

The regulation of shared ATMs has been before the Committee and it is a narrower issue. The question is whether a shared ATM should be considered a branch under the McFadden Act and thus subject to federal and state branching limitations. CBA does not believe that a shared ATM should be considered a branch and we also believe that federal regulation is responsive and appropriate and that further state regulation is unnecessary.

The Comptroller has issued a regulation and a number of interpretive letters that define the legal parameters of a shared ATM network. The systems are expanding, they operate efficiently, and they provide consumers with convenient access to their accounts. What purpose would an additional layer of state regulation serve? We have also discussed this issue in our answer to Question #9.

We would like to respond to your statement that "... national banks would have a substantial competitive

advantage over state banks contrary to the basic principles of the McFadden Act and the dual banking system." It is our understanding that the McFadden Act was passed in order to protect the national banking system by redressing the competitive disadvantage national banks had suffered prior to their receiving branching authority from Congress. We do not believe that the McFadden Act was intended to ensure "perfect equality" between state and national banks. That is an impossible task. Further, the Comptroller's regulation that excludes shared ATMs from the definition of a "branch" under the McFadden Act does not give national banks a substantial competitive advantage over state banks. An overwhelming majority of states have enacted legislation or issued regulations that permit the deployment of shared ATMs.

The survey included in the introductory remarks accompanying S.1148 relates to those states which permit out-of-state proprietary ATMs. Since proprietary ATMs are considered "branches" under the McFadden Act, national banks are at a disadvantage vis-a-vis state banks, as they can not place proprietary ATMs even in those seven states that permit placement of ATMs by out-of-state institutions, because section 36(c) of the McFadden Act prohibits interstate branching. However, shared ATMs are treated differently. A vast majority of states permit out-of-state institutions to share ATMs.

In sum, the question of whether or to what extent state law should apply to proprietary ATMs or branches should be considered in the context of a discussion of interstate banking. CBA would only support state regulation when it is shown to be necessary and vital to the dual banking system. We would not support state regulation that would be unnecessarily burdensome.

At the present time, shared ATM networks are operating efficiently, economically and responsibly. National bank participation is governed by the Office of the Comptroller. While state banks comply with their respective banking statutes and regulations, we would question the need to upset the present balance and require national banks to comply with both federal and state law.

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